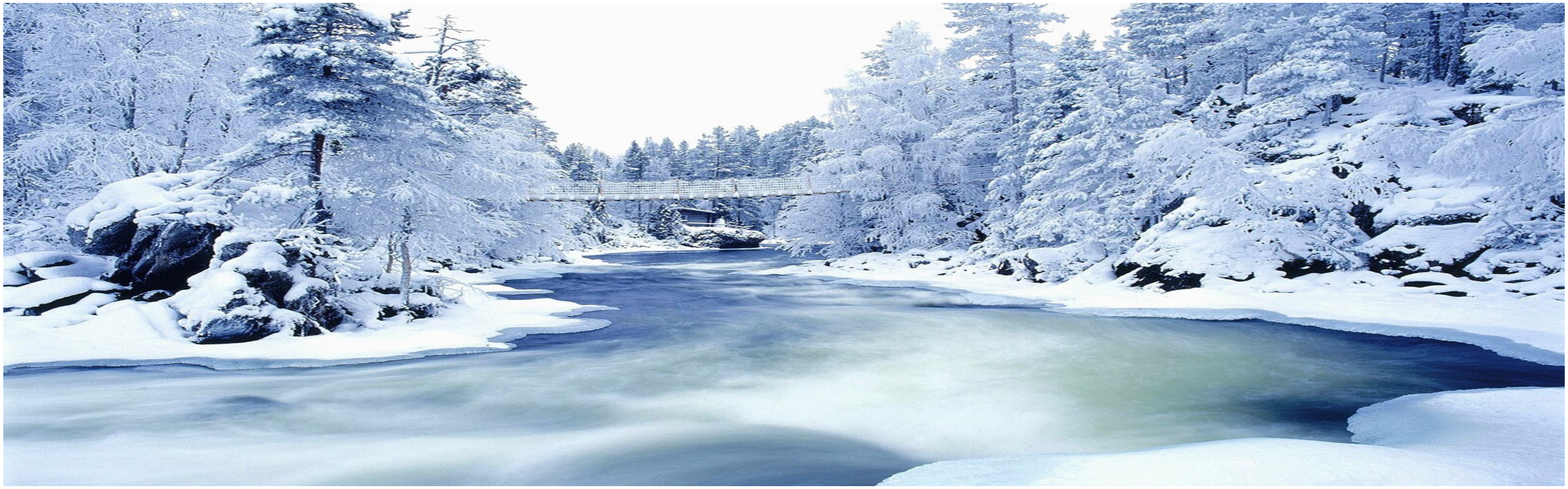


Quarterly Update & Economic Commentary—December 31, 2017

QUARTER IN REVIEW

The fourth quarter saw a strong finish to a great year for the equity markets. The S&P 500's 6.64 percent quarterly return was the best quarterly return since the fourth quarter of 2015. The calendar year return for the S&P 500 was 21.83 percent which represents the best calendar return since 2013. Growth stocks outperformed value stocks by a significant margin and large cap domestic stocks outperformed small cap stocks. Leadership came from the Technology sector which returned over 38 percent for the year while the biggest detractor was Telecom which lost 1.25 percent in 2017. Broadly speaking, international stocks outperformed their U.S. counterparts for the first time since 2012. The MSCI Emerging Markets Net Return Index returned 37.28 percent and the developed market's MSCI EAFE Net Return Index returned 25 percent.

Bond returns were fair during 2017. The Barclays US Aggregate Index returned 3.54 percent while high yield bonds, which carry more credit risk, returned 7.50 percent, as represented by the BBgBarc US Corporate High Yield Total Return Index. Interest rate movements were dependent on the maturity of the bonds. The short end of the yield curve moved significantly higher. The 2-year U.S. Treasury rate moved 0.69 percent higher to 1.89 percent. As you move further out the yield curve, the direction of the movement changed. The 10-year U.S. Treasury rate fell 0.05 percent to 2.40 percent and the 30-year Treasury rate fell 0.32 percent 2.74 percent. The short-end of the curve is being influenced by the Fed's decision to raise interest rates, while the longer-end of the curve is taking direction from the lack of inflation.

In addition to the strong performance of the equity markets, commodities also performed well. Copper prices were a leader, finishing up over 30 percent. Nickel was not far behind at 27 percent and gold prices moved higher by 13.68 percent. Both Copper and Nickel had strong fourth quarters, returning 11.93 percent and 27.47 percent, respectively. Oil prices had a good year. Brent Crude prices moved higher by more than 17 percent and WTI oil increased by over 12 percent. High oil prices did not help the energy sector as it was one of only two S&P sectors to have a negative return during 2017. A major loser in the commodity space was natural gas which lost over 20 percent during the year.

One of the driving themes for 2017 was the unusually low volatility. The S&P 500 was positive every month during 2017 and is currently in the midst of a streak that is 14 consecutive positive months and counting. Additionally, the biggest peak to trough decline was 3 percent, which is the smallest calendar year decline in over 20 years. The VIX, often referred to as the Fear Index, traded below 10 on 92 different days during the year compared to a total of 18 days since the index's inception in 1990 through the end of 2016. This anomaly makes for an enjoyable ride but investors should not expect such low volatility in the future.

Arguably the biggest economic news of quarter, and probably the year, came from Washington when the GOP-led Congress passed tax-reform. This is the biggest tax-form bill since the Reagan-era Tax Reform Act of 1986. The President kept his promise and signed the new bill before Christmas. The most significant portion of the bill was cutting the corporate tax rate from 35 percent to 21 percent. The new tax rate will make the U.S. corporate tax rate more competitive globally. Most individual tax payers will also see a small reduction in their tax bills at least for the next couple of years.

The Federal Reserve continued on their expected path of raising short-term rates and beginning to reduce its balance sheet. President Trump announced that he would be replacing current Fed Chair Janet Yellen with current Fed Governor Jerome Powell. This seems to be a conservative selection with very little expected divergence from current policy. The market may have to learn how to interpret Chair-elect Powell's style when conducting news conferences and speeches but overall we are not expecting any drastic changes coming from the Fed. In addition to the departure of Chair Yellen, former Fed vice Chair Stanley Fischer officially stepped down in October and New York Fed President William Dudley announced he will step down in mid-2018.

We continue to see strong underlying fundamentals. Companies had another strong earnings season. The S&P earnings growth rate for the third quarter was more than 6 percent and companies with more than half of their sales coming from outside the U.S. had higher earnings than companies with more than half of their earnings coming from inside the U.S. Improving global growth and a weaker dollar contributed to the better earnings from multi-national companies.

In addition to the strong earnings season, economic indicators continue to look strong. The current third quarter reading for the gross domestic product (GDP) is 3.2 percent which follows the second quarter reading of 3.1 percent. The economy has not seen back-to-back 3 percent readings since the second and third quarters of 2014. The unemployment rate in the U.S. remains low at 4.1 percent, although wage growth remains tame at 2.3 percent.

The consumer is feeling good and contributing to growth. Two different consumer indicators, the University of Michigan consumer sentiment survey and the consumer confidence survey are both at or near multi-year highs. Holiday shopping was strong during the quarter. Retail sales in November were up 5.8 percent year over year and Mastercard Spending Plus is projecting the strongest holiday season sales growth since 2010, which should surpass 5 percent year-over-year growth. Auto sales continue to impress with a current annual sales pace above 17 million and new home sales rose to a more than 10-year high in November.

Global economies are also continuing to look strong. The GDP growth in the Eurozone remains above two percent and the unemployment rate continues to drop. The current Eurozone unemployment rate is 8.8 percent down from a peak of 12.1 percent in May of 2013. Japan is seeing similar economic strength. GDP for the third quarter was 2.1 percent and the unemployment rate is at 2.7 percent.

A Look At the Numbers

Name	4th Quarter Performance (%)	YTD Performance (%)
DJ Industrial Average TR USD	10.96	28.11
S&P 500 TR USD	6.64	21.83
S&P MidCap 400 TR	6.25	16.24
S&P SmallCap 600 TR USD	3.96	13.23
NASDAQ Composite TR USD	6.55	29.64
MSCI EAFE NR USD	4.23	25.03
BBgBarc US Agg Bond TR USD	0.39	3.54
Wilshire US REIT TR USD	1.70	4.18
IA SBBI US 30 Day TBill TR USD	0.26	0.80

FORECAST IN BRIEF

The strong equity market in 2017 surprised many investors and, naturally, the question that many ask is whether the ride can go on. Let's face it, equity investors have fared very well since the Great Recession. The return of the S&P 500, not including reinvestment of dividends, since the market bottom in 2009 is 295 percent. This rally is now almost nine years old. Despite the strong performance and the length of the market rally, many stock market pundits and analysts are calling for another strong year in the market. Let's take a look at a couple of reasons why you should be bullish for the upcoming year and then some events that could derail the optimism.

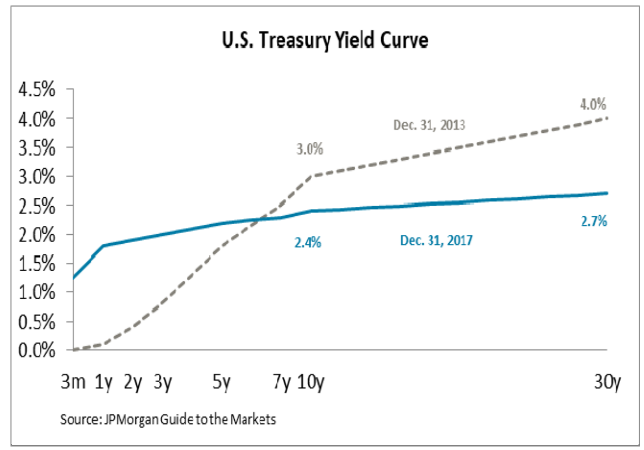
The President's tax reform bill will go into effect in 2018. As mentioned above, a significantly lower corporate tax rate is the most significant piece of the legislation. By simply paying lower taxes, corporate earnings will increase, making valuations less expensive and stocks more attractive to purchase. In addition to the bump in earnings, companies will have more money to potentially spend. A portion of these funds is expected to go towards bonuses for employees, capital expenditures, pay dividends, fund buybacks or to fund mergers and acquisitions. In addition to having better cash flow, companies will also be able to bring back cash held overseas at a lower tax rate. These assets could also be used to fund some of the expenditures listed above.

The impact of tax reform will have less of a financial impact on individuals but most Americans will be paying less in taxes for 2018. Additionally, as mentioned above, some may also receive a one-time bonus in 2018 that will increase income. Consumer confidence is already at a high mark and coupled with the continued expectation of a strong jobs market and the potential for higher wages the consumer should feel comfortable to spend money.

The President has indicated that he intends to focus on an infrastructure bill in 2018. On the Presidential campaign trail, this was one area that both Republicans and Democrats agreed upon which is why many believed it should have been the President's first priority once he got in office. It is doubtful that Republicans and Democrats will work together given the mid-term elections in 2018 but if an infrastructure bill can get passed, it would provide an additional boost to the economy.

Global synchronized growth was strong in 2017 and this is expected to continue into 2018. Europe and Japan are both on better footing right now then 12-months ago and both countries are using monetary policy to continue to stimulate their economies. Granted, there remain some structural concerns in both regions but it is possible that economic growth can hide these other issues over the short-term.

There are a lot of reasons to be bullish on the economy but there are also some risks that could derail the momentum.



Source: JPMorgan Guide to the Markets

The Federal Reserve is a potential risk. 2018 will bring many changes to the leadership of the committee. This should not have a significant impact but there may be an adjustment period for the market to get used to the new Chair's communication style. More concerning to the economy is the risk of the Fed raising interest rates too fast. During the second half of 2017 the spread between the 2-year and 10-year treasury yield began to tighten to levels that caught many market watchers attention. When the yield curve inverts, or to say it differently, when the 10-year or longer treasury yields are lower than the 2-year treasury yield, it is a strong signal of a recession. Recessions are typically not positive for the stock market. As of this writing, the spread was around 50 basis points, but if the Fed meets expectations by raising rates three times in 2018, and inflation remains low, then an inverted yield could be on the horizon.

Most signs in Europe point to better times ahead, with the main exception being the United Kingdom. As Brexit negotiations drag out with little clarity on what the future holds, company decision making will be delayed which could hurt the employment picture and the economy. A downturn in the U.K. is unlikely to bring a global recession but it could impact European growth. With the economic picture looking brighter throughout most of Europe, the European Central Bank is likely to end asset purchases late in 2018. If the economy is not strong enough to stand by itself, the European economy may falter.

There continues to be a risk of war with North Korea. Both Trump and Kim talk loosely about war and attempt to intimidate each other with missile tests, parades and war games. Even if an intentional attack is not made, the risk of an unintentional event or accident is rising and any retaliation for any such event would be catastrophic. In addition to the already high attention on the region, the Winter Olympics will be held in South Korea in February.

Another potential risk is over optimism. Consensus is usually not a positive indicator on Wall Street. Just last year, the consensus trade was for the dollar to strengthen and yet it saw significant declines. We hear constantly from CNBC guests, news anchors, mutual fund representatives and others that fundamentals are strong and that markets will have another great year. While we acknowledge most of the supporting numbers to be true, and believe many of the obvious either risks are a low probability or not systemic enough to stop the rally, we still get concerned when everybody gives the same positive forecast.

The current outlook for the economy and markets is positive. The domestic picture looks strong: low unemployment rate, low interest rates, cheap relative gas prices, lower taxes and less regulation should lead to another positive year for the markets. With that said, it is appropriate to recognize that the mood can change quickly and investors should make investment decisions based on their individual situation, not on stock market and economic forecasts.

If anything has changed with your financial picture that may affect your investment strategy, please let us know so we can make any necessary changes.

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